DOES IT PAY TO BORROW ?

EM 36
GI ROUNDTABLE

This pamphlet is one of a series made available by the War Department under the series title *GI Roundtable*. As the general title indicates, *GI Roundtable* pamphlets provide material which information-education officers may use in conducting group discussions or forums as part of an off-duty education program.

The content of this pamphlet has been prepared by the Historical Service Board of the American Historical Association. Each pamphlet in the series has only one purpose: to provide factual information and balanced arguments as a basis for discussion of all sides of the question. It is not to be inferred that the War Department endorses any one of the particular views presented.

Specific suggestions for the discussion or forum leader who plans to use this pamphlet will be found on page 41.

WAR DEPARTMENT

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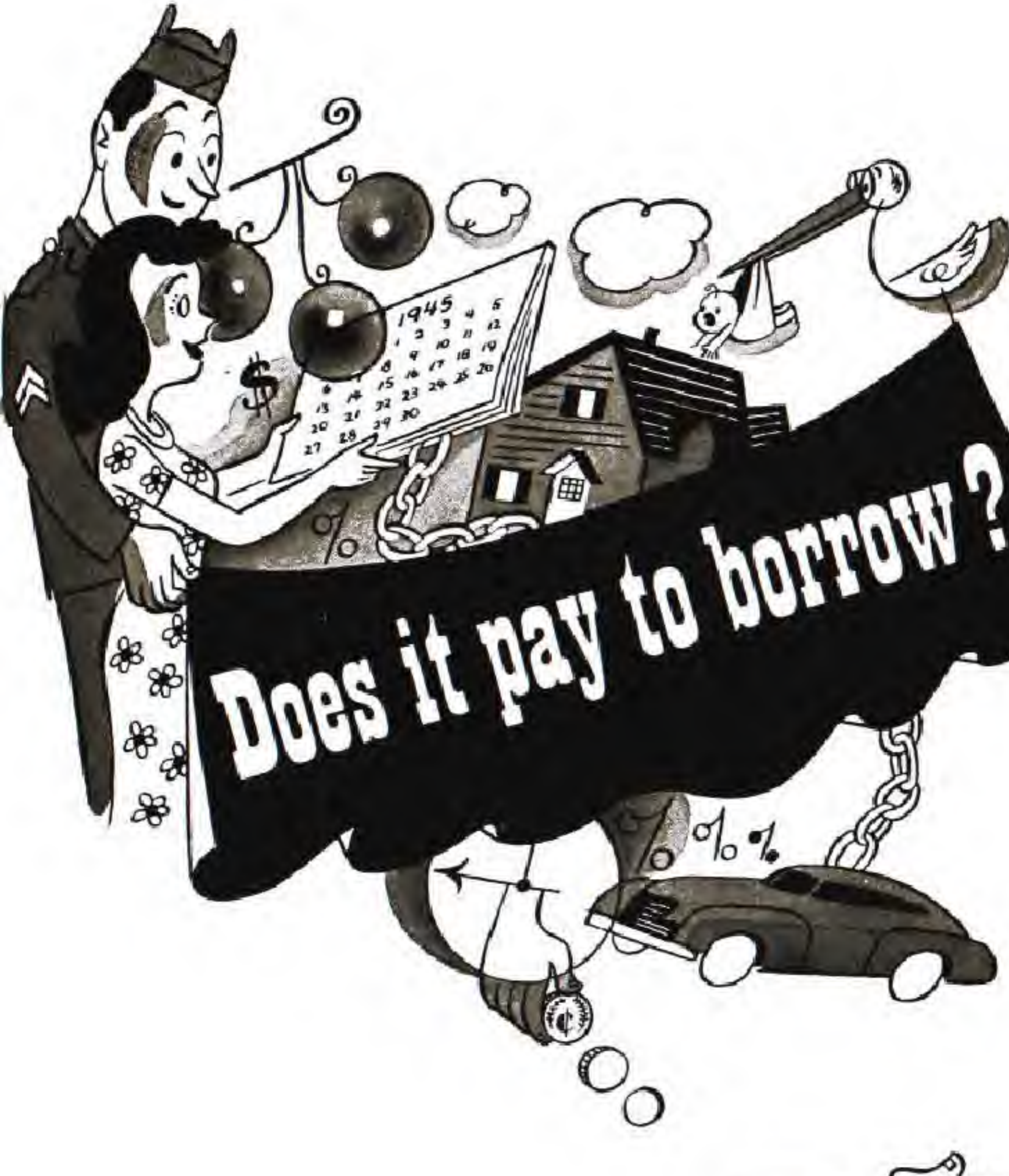
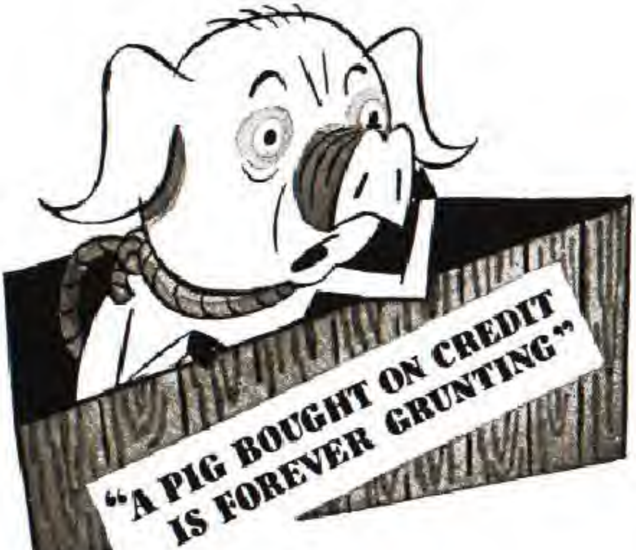


LET'S FIND OUT


"A PIG BOUGHT ON CREDIT
IS FOREVER GRUNTING"

SOUNDS like foolish question No. 999, doesn't it? Most of us are quite sure we know the answer. Of course it doesn't pay to get into debt. A few of us, on the other hand, may be equally sure that it's an easy way to get things—and worry about paying for them later. "A dollar down and a dollar when they catch me" is the lighthearted motto of such folks.

But is it really as simple as that?

Are you sure your answer will stand up if you really stop to think about it? Haven't you known even wise and prudent men who found themselves in debt? A man may not have any choice about it. Through bad luck and no fault of his own—long sickness, an expensive operation, a fire which wiped out his personal belongings—even the most independent and self-reliant of us may be forced to borrow.

And aren't there other times when borrowing may be wise, even when it isn't absolutely necessary? Where are you going to get the cash to make your foxhole dreams come true after "this is over"? Many a soldier who married the girl back home before he shoved off is going to return to a brand-new family, to responsibilities he never knew before. How is he going to meet them?

Can't a loan be a wise investment?

How many of us could hope to buy homes if we had to pay cash for them in advance? Haven't many men borrowed money to put themselves through college, and profited immensely from doing so? Could very many men start out in business for themselves without the help of borrowed capital? Isn't it true that even the biggest corporations in this country are in debt? If you doubt it, take a look at the bond listings in the financial section of your daily newspaper.

Debt is a two-edged tool. Under some circumstances going into debt may result advantageously, profitably. Under others it can so burden a man or a family as to ruin their lives. Like any sharp tool, the best way to handle it without hurting yourself is to know its proper uses.

So, before deciding we know all about it, let's look into this matter of debt. Some day that knowledge may pay us in dollars and cents.

What is debt?

That sounds simple. Most of us would answer that debt is owing money. Actually, however, it doesn't have to be money. Suppose a farmer paid you in advance to plow a field for him the following week? You would owe him work, not money, but it would be a debt just the same. Or sup-

pose you sold an antique chair from the attic for cash, and agreed to deliver it after you had fixed it up? Then you would owe a chair, not money.

Debt is created whenever one of the two parties to any transaction puts off turning over his end of the transaction —the money or the things or the work he is promising— but gets immediately the valuable consideration from the other party.

The other side of the picture

The opposite of debt is credit—and yet the two can never be separated. Credit is the Latin for "he believes." The grantor of credit believes that the borrower will keep his promise to pay. Debt and credit are two faces of the same thing—deferred payments. The big difference is that debt is a liability to the man who owes it, but an asset to the creditor.

Can you get into debt without borrowing?

A minute's thought will answer that one. There are a great many ways of getting into debt without borrowing. You might hire someone to fix your sidewalk. Then you would be in debt to him until you had paid him. Or you might have the bad luck to get into an automobile accident, and be held

liable for damages. Or you might be hurt yourself, and have to have the doctor look after you. In that event you would owe him for his services until you paid him.

The city puts taxes on your home; the federal government puts a tax—the income tax—on your pay. Both of these constitute debts until you pay them. You might subscribe to the Community Chest, promising to pay in quarterly installments. That, too, would be a debt. Or your wife might get a divorce and the judge might grant her alimony. That would be still another kind of debt.

So you see that it is possible—most of us might say easy—to get into debt unwillingly and unwittingly.

In many cases you cannot stop to weigh the advantages against the disadvantages and decide whether it would pay you to go into debt. Life is filled with the unexpected. The income and the expenses of most of us are subject to such changes that even the man who is a good manager may need luck to keep out of debt.

There are, however, certain guiding principles which the intelligent man should know and follow in managing his finances.

What does it cost to default?

The first of these principles is that there are heavy penalties for failing to pay one's debts. This has been true from ancient times, when the way of the debtor was even harder than it is now. In those days the man who owed a debt he could not pay was held as a slave by his creditor, until he worked off the debt or it was paid for him by his friends.

In modern times imprisonment for debt has been abolished, and so the debtor need not fear being clapped into jail, unless he is guilty of fraud. But there are other

penalties still existing. The creditor can sue the debtor who fails to pay, and get a judgment permitting him to seize the property of the debtor to make good the debt.

How about the bankruptcy laws?

It is true that the bankruptcy laws do give some protection to the man who owes more than he can possibly pay. If he can convince the courts that he cannot pay, then his assets, above a certain minimum which is exempt, will be divided among his creditors, and the man will be declared bankrupt, thereby voiding his debts and giving him a chance to make a fresh start.

But the blot on the financial record and reputation of a debtor who has defaulted will turn out to be a serious punishment to him. He may think that only a few persons know about it and that it will soon be forgotten. If so, he is likely to get an unpleasant surprise.

How does the word get about?

In every city there is a credit bureau which combs the records of the bankruptcy courts daily for information. The retail

stores, the banks, the personal loan companies, the automobile dealers, and other businesses exchange information about customers who do not pay their bills. This too soon reaches the credit bureau.

Once a man gets a bad rating with the credit bureau, he will find that it is difficult for him to buy anything on credit or to borrow money. Even if he moves to another city his bad rating is likely to pursue him, for the credit bureaus of the various cities cooperate by exchanging information.

It may take a decade of hard work and thrift to live down such a bad reputation.

Do you want your own business?

A good financial reputation is *absolutely essential* to the man who hopes to have a business career. Have you ever known a man who appeared to have all the qualities necessary for success, except that he couldn't be trusted? Unfortunately, there are many such. It will not pay anyone who is ambitious for a business career to have unpaid debts, no matter what he gains otherwise, if by doing so he ruins his financial record.

Are good intentions legal tender?

Good intentions are not enough; the debtor must also have the means to pay.

Deliberately going into debt is something that should be done only after a great deal of thought and planning. That is especially true when a large sum is involved. *The whole family should be convinced of the wisdom of the step, because every member may have to make sacrifices to keep up the payments.*

How many kinds of debt are there?

It might be easy to wisecrack that there are two kinds of debt—good and bad. The economists who study these matters seriously agree that there are two kinds, but they classify them differently. They call them "consumer credit" and "producer credit," depending on the use that is going to be made of the proceeds of the debt.

What is consumer credit?

A debt contracted for the purpose of increasing present consumption is called consumer credit. *This is the only kind of debt that most ordinary persons ever contract.*

People go into debt for all kinds of things—to buy food or clothing; to get a place to live; to travel; to go to football or baseball games; to bet on the horses; to contribute to worthy causes; to pay doctor bills.

You may think that some of these things are good and that others are bad, but *the important consideration for us is that whether they are good or bad, they are not going to help us directly to pay back the debt.* Good health helps to pay the doctor bills, in a way, and a well-dressed appearance

may help to pay the tailor—particularly for a bond salesman. But by and large, debts of this kind have to be paid back out of wealth or income that has not been increased by the debt.

What does consumer credit do?

Consumer credit advances the time of consumption, but not its amount. Over a long period of time no one can possibly get more automobiles, radios, dinners, theaters, or clothes by going into debt for them. He may have more of these things this month or this year by going into debt, but he will have to get along with fewer of them next year.

Indeed, consumer credit will eventually reduce the amount a man can enjoy, because part of the debtor's income will have to go to pay the interest charges on his debt.

Is this an evil?

Are there some occasions when it is more important to advance the time of consumption than it is to wait for the time of maximum consumption? Most of us, on thinking it over, will undoubtedly say yes. For instance, thousands of men will go home to wives they married after they were in the service. Many of them will have to choose between buying furniture on the installment plan and setting up their own homes, or living in a furnished room, or with his or her parents. What would be your decision?

To take another example, parents might be warranted in going into debt to enable their children to get an education, since the education cannot be delayed if it is to be of value. The man who borrows to put himself through medical school almost certainly increases his ability to earn and pay off the debt. An individual who loves the piano might buy one on

1941 TOTAL INSTALLMENT SALE CREDIT	$3,747,000,000.00
Automobiles	51.8%
Furniture Stores	16.5%
Dept. Stores & Mail Order Houses	12.5%
Household Appliance Stores	8.4%
Jewelry Stores	3.2%
All Other Stores	7.6%

the installment plan, fully aware that the monthly payments will cut into his future purchasing power, but willing to make that sacrifice for the enjoyment he will get out of the instrument. For a music teacher, however, a debt of that kind would not be for consumption but for production.

Is our standard of living supported on credit?

Consumer credit, although it cannot in the long run increase the total amount of goods sold, does have an important effect on what is sold. That is because consumer credit is more readily advanced for certain kinds of goods than for others.

Would you expect to buy a house or a piano or a stove or an automobile on the installment plan? Most of us would say yes. Would you expect to buy groceries on the installment plan? That hardly needs an answer.

Installment selling started with things that cost more than ordinary purchases and lasted for a long time. The main reason for this was that the seller could protect himself against loss on such articles by taking them back if the buyer fell too far behind on his payments. Obviously this right wouldn't be worth much if the goods had been consumed or had shrunk greatly in value.

As the installment system has become more and more popular, it has become possible to buy some things that are more quickly worn out, such as clothing, on the installment plan. One result of this development is that *it is easier and easier to get into debt.* It remains true, however, that installment selling is more commonly used for things that have a high cost and a long life.

You can't buy a car and eat it, too!

Since installment credit does not increase the buyer's income, and since most of it is granted for buying expensive long-

lasting goods, the net result must be to cut down the amount of money that the buyer has available for such ordinary expenses of living as food and drink, amusements, and travel.

"Buy on Easy Terms. Take Nine Months To Pay," say the ads on the billboards. It sounds so simple and so easy. And sometimes it is. But when you buy on the installment plan, do you always stop and realize that you are going to have to do without other things that you could otherwise enjoy?

Manufacturers of automobiles, radios, and many other high-cost goods often state that installment credit has done wonders in expanding their sales. That is true, but it has accomplished this by diverting expenditures from other things not sold on the installment plan.

It is also true, of course, that the larger sales of these high-cost goods have helped to bring about mass production, which in turn has greatly reduced the cost of these articles. Sometimes it is contended these price reductions more than offset the cost of the installment credit. What do you think? The economists claim it is impossible to prove this.

Does debt influence the way you live?

When a man has gone into debt for something that cost him a lot of money—say a house—he will usually make every effort to keep up his payments and thus retain possession of it, even though his income may have dropped sharply. That means he may have to skimp on such things as food or clothing or the education of his children.

Have you ever known anyone who was "land poor" or "automobile poor" or "radio poor" because he had pledged so much of his income to keep up the payments on one of those things that he didn't have enough ready cash to look

after his family properly? Plenty of men have made that mistake.

A hard way of saving

"I'm going to get me a new automobile just as soon as I get out of uniform and get enough dough together for the first down payment," says Pfc. Happy-Go-Lucky. "I figure I deserve a little fun."

"You dope, you'll get more headaches than fun," says Sgt. Thrifty. About all you'll ever use that car for is running away from bill collectors. Why don't you get wise to yourself and save your dough instead of blowing it all in?"

"I figure I will be saving it if I put it into a car," says Pfc. Happy-Go-Lucky. "That's better than blowing it on dames or liquor, isn't it? You got an automobile, you got something to show for your dough. And besides, the girls like 'em."

"You'll be way ahead of the game if you save the price of the car first," says Sgt. Thrifty. "Stick fifteen bucks in the savings bank every week for a year. That way you'll get paid interest, instead of having to pay it yourself. And when

you've got the dough ready you can shop around and get a really good buy—and not have to worry about the sheriff catching up with you, either."

"Buddy, you don't know me," says Pfc. Happy-Go-Lucky. "That way I never would get a car—or save any money either. I know my own weaknesses. If I have to keep up the payments on a car or lose it, I'll keep them up. But I just couldn't sit around home for a year and watch my bank account grow. First thing you know I'd be off on a toot and that would be the end of bank account and car both."

Do you know anyone like Pfc. Happy-Go-Lucky, who recognizes his own weakness and deliberately incurs debt in order to force himself to save? There are plenty of men like that. Many a radio, a refrigerator, even a home has been bought with money that would otherwise have been dropped in a poker game or a slot machine, because some man compelled himself to keep up the payments on something he wanted.

Thus, for one who lacks the will power to save in advance, going into debt may pay. *But it is a hard, an expensive way of saving.*

How does debt affect character?

It takes all kinds of people to make a world, and there are plenty who can't look upon being in debt as cheerfully as Pfc. Happy-Go-Lucky. "The borrower is servant to the lender," says the Bible (Proverbs XXII: 7). Most men do not like being beholden to anyone. They agree with the Spanish author of the saying, "A pig bought on credit is forever grunting."

Have you ever noticed how being chronically in debt affects a man's character? In many cases it saps the will to

save and weakens his self-respect and his integrity. History shows beyond argument that chronic debt also impoverishes the debtor, as more and more of his income is eaten up to pay service charges and interest on his accumulated debts.

Can the government do anything?

For hundreds of years governments have tried to prevent this evil, or at least limit it, by laws against usury. Back in the Middle Ages usury was the name for any interest at all, no matter how low the rate. It was considered wicked then to charge interest on a loan. But that idea was gradually discarded. Now the usury laws only forbid the charging of extortionate rates of interest.

Did you ever know anyone unlucky enough to fall into the hands of a loan shark? And did the laws against usury help him? All through history endless ways of evading these laws have been devised by ingenious and unscrupulous lenders.

The principal protection for a debtor nowadays is not the laws against usury, but the competition of lenders for his business. And so let's take a look at the principal kinds of consumer credit.

Do you like charge accounts?

The most common form of consumer credit is called by the economics professors "book credit." Book credit is made up of the bills we run up at stores where we charge things, with the milkman, the filling station, or the tailor. It is largely a matter of convenience to the buyer. He does not have to carry so much cash in his pocket or write a check for every purchase. Instead, he wipes out the bill with a single payment at the end of the month.

But book credit is expensive to the seller. It requires bookkeeping, billing, mailing, and collecting expense. There is a loss from bad debts. Considerable extra working capital is tied up in these accounts receivable.

To cover these costs of doing business, higher prices must be charged. Stores that do a strictly cash business usually sell things cheaper than those that offer credit. Is the added convenience worth the extra cost? That is a question every man must answer for himself.

How about the installment system?

Some businesses that sell on the installment plan have enough working capital to carry all or most of their accounts until they are paid. But many others do not. These can either borrow from a bank, by pledging the accounts receivable as collateral, or they can sell the note received from the debtor to a bank.

Or, if the seller does not do business on the installment plan, the buyer can go to a bank himself and borrow the amount of cash he needs for his purchase, arranging to pay back the loan on the installment basis.

Because the commercial banks were rather slow in developing this business, the finance companies, with which many

of us have had experience, got their start. They finance the sale of automobiles, radios, furniture, stoves, sewing machines, jewelry, pianos, refrigerators, and other high-cost, long-lasting goods, on an installment basis. The seller of these goods turns over the notes signed by his customers and gets cash, and the customer then pays the finance company.

It is a universal rule in credit granting that the lender does not want the borrower to default. He does not want to have the trouble and expense of a court action to repossess the article in question, and then of having to sell it again. Therefore the creditor will usually cooperate with the debtor if the latter has had misfortunes that make it impossible for him to make his payments on time.

Do you ever need cash in a hurry?

If you don't you're lucky. Most of us have known that sinking feeling in the pit of the stomach that results from the unexpected and unforeseen need for a considerable amount of money. Hospital and doctor bills, for instance, or funeral expenses, or damage caused by a fire may create that need.

You may be able to borrow what you need from a friend, but more likely you will have to resort to a person or institution in the business of lending money. The most important of these are loan sharks, personal loan companies, the personal loan departments of commercial banks, life insurance companies in which you are a policyholder, and industrial banks.

Loan sharks

Loan sharks, who charge higher interest rates than the usury law allows, continue to thrive in spite of the efforts of the

authorities to put them out of business and send them to jail. They have invented many ways of evading the law. Some of them take chattel mortgages on the furniture or other property of the borrower. Some take an assignment of his wages as security. Some buy his property at a ridiculously low price as part of an agreement under which he promises to buy it back at a much higher price.

Pity the man who falls into the clutches of a loan shark! He is likely to find himself getting ever deeper and deeper into debt until his plight is hopeless. The best thing he can do is go to the police or the district attorney with a frank statement of his difficulties.

Personal loan companies

Personal loan companies, which are privately owned and operated for profit, have arisen as the result of the so-called "Uniform Small Loan Law," enacted in almost all states largely through the efforts of the Russell Sage Foundation.

After careful investigation, the Foundation concluded that the most effective way of combating usurious lending was to authorize an interest rate on small loans that would be sufficient to attract men of good character, with the needed capital, into the business.

The Uniform Small Loan Law regulates the business of lending sums under \$300, at rates in excess of the legal contract rate. It requires that the lenders be licensed and supervised by the state; have a minimum capital of \$25,000; be of good character; and charge an interest rate of not more than 3½ per cent a month on unpaid balances only, not to be compounded.

The small-loan business cannot be conducted on the usual legal rates of interest. The expense of making these loans

is high because each loan is small in amount; is made only after special investigation; is secured, if at all, by collateral that is hard to liquidate; and involves much bookkeeping and other expenses of collection.

The personal loan companies usually obtain their funds largely through the sale of common stock, on which they must pay adequate dividends. Therefore the loan rate must be high enough to cover not only their high operating costs, but also to provide dividends.

The rate of 3½ per cent a month was recommended by the Russell Sage Foundation after experiments had shown that lower rates made the companies stop loaning such small sums as $25 and $50, thus throwing the poorer applicants back into the clutches of loan sharks.

However, the permitted rate of 3½ per cent a month is actually 42 per cent a year.

Personal loan departments of banks

In recent years many commercial banks have opened small-loan departments. They usually follow much the same

methods as the personal loan companies. But since they get their funds from demand deposits, which cost the banks very little, they can usually afford to lend at lower rates than the personal loan companies.

In some states the mutual savings banks, and in three states the savings and loan associations, have been authorized by law to make small loans. These institutions will also lend against a customer's account book, on very easy terms. This is one of the best types of consumer loan since the borrower has a record of thrift. The loan will cost him little because his account continues to earn interest or dividends while the loan is outstanding.

Insurance policy loans

Life insurance policies customarily have a certain loan value, which is the amount that the company will lend the policyholder at any time against the cash value of the policy. One of the commonest reasons for such borrowing is to avoid defaulting on a premium payment that is due. If the policyholder desires to borrow over a considerable period, this may be the best way of doing so. But if the amount is small and he expects to pay it off in installments fairly soon, he may find that pledging the policy at a bank and borrowing against it is cheaper. But he may also find that it involves more red tape than borrowing from the insurance company.

In the first World War, the government began the practice of insuring the lives of the men in the armed forces. The holders of these policies were likewise able to borrow against them. When adjusted compensation certificates were later issued to veterans, their loan value, increasing each year up to maturity, was printed on them. Many holders of these certificates borrowed against them.

One year after National Service Life Insurance policies issued by the government in this war are converted into permanent policies, they begin to have loan value. As long as premiums are paid up, loans at 5 per cent interest and up to 94 per cent of the cash value may be obtained at any time. Veterans who need money badly should not overlook this cheap and ready source.

Industrial banks

The first "industrial" bank in this country, patterned on a European model, was established in 1910 by Arthur J. Morris of Norfolk, Virginia. The installment loan idea proved very successful. Morris Plan banks and other institutions of the same type that copied the basic idea now exist throughout the country.

Since 1910 many Morris Plan banks have expanded their operations into other phases of banking. At the same time, many commercial banks have moved into the field of "industrial" banking by adding small-loan departments which operate in much the same way as Morris Plan institutions.

The distinctive features of the industrial bank on the Morris Plan are best described as they were originally established 35 years ago. At the start, Morris Plan banks did not accept pawns, chattel mortgages, or salary assignments as security for loans. In general they loaned to any responsible person of good character who could get two other responsible men to endorse his note. The borrower and the endorsers first had to establish their credit by filling out application blanks covering their character, financial record and responsibility, employment and income.

On approval of the application, all would sign a note running for a year. The borrower received the face value of

the note, less interest at, say, 6 per cent and less an investigation fee of $1 for every $50 borrowed. As security for the note, the borrower had to pledge an "investment installment certificate" of the same amount as the face value of the note. He agreed to pay for this by a regular series of installments of equal amounts.

Some Morris Plan institutions still operate under the original system. But many have since greatly relaxed these rules in so many different ways that no general description can cover them all. By and large their operations are little if any different from the industrial loan departments of commercial banks.

In their original form Morris Plan banks made loans only for useful purposes, such as to meet sudden expenses that developed from illness or misfortune or served to increase one's earning power. Advocates of the Morris Plan claim that it promotes thrift, by training people in regular weekly payments; and that it preserves self-respect, for the loans are made at a reputable place, in a businesslike manner, and are based on character and habits.

How much does consumer credit cost?

The borrower on an industrial type loan should realize that because the certificate is purchased on the installment plan, and because of certain other charges that are included, the actual interest rate on the debt is twice or more the nominal rate.

There are many different ways of computing the interest rate on a debt that is being paid on the installment system. The lender will usually adopt the formula that makes the rate appear lowest. *The prudent borrower will be skeptical of this figure until he has worked it out for himself.*

For example, let's suppose that you borrow $100 from a bank of the Morris Plan type. If the note is discounted at 6 per cent, plus a 2 per cent service charge, you would actually receive $92. In return you would agree to make fifty weekly payments of $2 each, or a total of $100. You might think, if you were not experienced in such matters, that you were paying 6 per cent, or at the most, 8 per cent interest.

Actually, however, you would have the use of $92 for one week; of $90 for one week; of $88 for one week, and so on, which is equal to an average unpaid balance of $41.58. You are really paying $8 for the use of $41.58 for the year, or at the simple interest rate of 19.2 per cent.

Take the case when you buy a $750 automobile by paying one-third down and agreeing to pay off the balance in twelve months. The finance company tells you that the finance charges will be $29.92 on the $500 you owe it. You might

think you were paying less than 6 per cent, since 6 per cent of $500 is $30.00. Actually, you would be paying at the annual simple interest rate of 11.6 per cent on the average unpaid balance, assuming that the financing charge is equally distributed over the twelve months.

Figure it out for yourself and know what you are getting into!

Can you figure out how much you would have saved if you had waited until you could pay cash for your car instead of buying it on credit? Suppose that instead of making your payments to the finance company you had deposited the same amount of money in a savings bank that paid 2 per cent interest. At the end of the year the accumulated interest would be $7.36. Therefore your $750 car would cost you a net of $742.64 instead of $779.92, as it did with the finance charges added.

Would the saving of $37.28 be worth waiting a year for?

Buying a home

Are you hoping to own your own home some day? You may not have thought much about it yet, particularly if you aren't married. But sooner or later it becomes one of the major objectives of most families. It's something that husbands and wives dream of for years before they are able to make it come true; something they plan for, work for, sacrifice for.

For the average family it is the most important financial decision they ever have to make. Their wisdom in deciding it may have a great deal to do with their future happiness. It therefore deserves the most serious consideration they can possibly give it.

How many families of your acquaintance were financially

able to buy their homes without going into debt? Probably none; certainly not very many. As most of us know, the common form of debt for the acquisition of a home is through a mortgage on the dwelling. If the buyer is unable to pay it off when it comes due or to keep up the payments, the mortgage will be foreclosed and the house sold. The buyer may lose all or a large part of what he has put into it.

Is it better to buy or rent?

To most people the idea of owning a home has a fundamental appeal. A home is the most tangible and desirable of all possessions. Owning one gives a deep psychological satisfaction that colors one's whole life.

Home ownership is likewise a good thing from the broader social, economic, and political standpoints. Have you ever noticed that the neighborhoods where people own their own homes are likely to be more stable, more tranquil, than where they rent? Home ownership advances one's standing with his neighbors. It encourages interest in local good government. It is an antidote for disintegrating influences in our local and national life.

How large a part of the American people own their own homes? The 1940 census showed that 40.7 per cent of the dwelling units in the United States were owner-occupied. You should bear in mind that in the rural areas, the towns, and smaller cities the proportion is very much higher than that. The figure for the whole country is pulled down by the very big cities, where most people live in apartment houses and cannot hope to own their own homes.

Real estate prices in general touched bottom in 1933, and the trend has been upward ever since. During the depression, the old practice of giving second and third mortgages

was practically wiped out. Because of governmental action, it became possible to finance the purchase of a home on much easier terms than was formerly the case. In many cases now, *it is as cheap to own as to rent, and far more satisfactory.* If you are interested, there is a *GI Roundtable* pamphlet that discusses the subject *Shall I Build a House after the War?* (EM 32).

But on the other hand —

The case is not, unfortunately, all one-sided. From 1926 to 1936 there were more than 1,600,000 foreclosures, every one of which shattered someone's dream of owning a home.

When the average man of modest income buys a home

with a small down payment, it is difficult for him to foresee how steady his earnings are going to be through the long period of years before the mortgage will be paid off. *He must bear in mind that the payments will have to be kept up, whether the times are good or bad.*

He may be transferred to a job in another town, or he may have to move to another town to get a job. In either case he must leave behind his partly-paid-for house. Often he will have to sell it at a price that means the loss of all or part he has paid on it.

Real estate values fluctuate widely over a period of years. There are peculiar trends in area and neighborhood values due to local causes, about which the home owner can do little or nothing.

Then there is the danger of some unexpected family emergency, such as a long, serious illness, placing such a heavy strain on the family income that the payments cannot be kept up.

In the light of all these hazards, one authority on the subject has said that it is unwise to go into debt to buy a home unless you have these three things: (1) A stable, dependable income. (2) A fair proportion of your income not already obligated. (3) A sizable reserve of liquid assets that can be drawn upon in an emergency.

What do you think?

How are you going to pay for it?

Even after you've made up your mind to own your own home, another big question must be answered. Are you going to buy a house already built or build one to suit your own taste?

Whether you decide to build or to buy, you are almost

certainly going to have to arrange for a mortgage on your new home in order to be able to swing it. One of the first things you will discover, when you start making the rounds of the lending institutions, is that *you must be able to make a substantial down payment.*

In fact, you will probably find that the larger down payment you make, the lower will be the interest rate on the mortgage, or, if you desire, you can have a longer time to pay off the principal. This is because the larger down payment makes you a better risk in the eyes of the lending institution.

Probably the best source of loans for veterans who wish to acquire a small home is the Servicemen's Readjustment Act of June 22, 1944, popularly called the "GI Bill of Rights." This will be discussed in detail later. Here it is enough to say that it provides for governmental guarantee of loans for this purpose on very favorable terms.

Are you familiar with the insured mortgage loan scheme of the Federal Housing Administration? If not, that is another possibility worth investigating, for it has already reduced the cost of financing a home for many thousands of families.

Under the FHA plan, for a new house complying with certain construction and location standards, you can get an insured loan up to 90 per cent of its appraised value, if that is not more than $6,000, and for somewhat lower percentages of higher values. The loan is actually made by private lending institutions, such as savings banks and other organizations. But because the lender is protected against loss by the FHA guaranty, the interest rate is lower than it would otherwise be. The rate is 4½ or 5 per cent for a loan extending for twenty or twenty-five years.

Fixing up the old homestead

If, instead of buying a new house, you prefer to repair, remodel, or modernize an old one, you should inquire at your bank or other regular lending institution about getting a loan for this purpose which the FHA will insure. FHA-insured loans of this type are made wholly on the character of the applicant, no mortgage or other capital being required. They may not be larger than $3,000, they run from one to three years, and they gradually shrink in size as they are paid off in monthly installments. The interest is expressed as a discount of $5 per $100 per year. In other words, on a $100 loan, a man actually gets $95 but agrees to pay back the full $100 during the course of the year. Since the balance of the loan decreases every month the true interest figures out to about 9¾ per cent.

Eligible veterans will also be able to get loan guaranties under the GI Bill to pay for repair, alteration, or improvement of their present homes.

Where else could you turn?

There are still other possible sources for your mortgage. Some lending institutions will make a straight loan, payable in one payment, either on demand or at a certain future date. *For most borrowers these are not desirable forms of loan.* They may come due at a difficult time. You may have to pay a premium for a renewal or an extension.

Would you find it easier to pay off the loan out of your income as you go along? Most borrowers prefer to do so, making their monthly payments conform to their income.

Some lenders also permit or require the borrower to pay taxes, assessments, and fire insurance to the lender on a monthly basis, allowing him interest on advance payments.

Then when these items actually become due, the lender pays them. *This method of spreading these costs evenly through the year relieves the home owner of many worries.*

Installment purchase loans

Installment purchase loans fall into two classes: the sinking fund loan and the direct reduction type. In the sinking fund loan, your monthly payments are put into a fund and invested against the day when the amount accumulated will be enough to pay off the loan with a single payment. The debt remains at its original amount for the whole period. How long that will be depends on the amounts paid in the installments and on the yield of the investments in the sinking fund. The investment may go "sour," of course, and if it does the borrower is the loser. *You never know just how you stand on this type of loan.*

In the direct reduction type of loan, every payment is devoted to three purposes: first to the payment of taxes; then to the payment of the accrued interest; and then to reducing the principal. Thus a payment of $10 a month will pay off a loan of $1,000 at 6 per cent in twelve years and seven months. A loan paid off in this way is said to be amortized.

Because the interest is charged only on the unpaid balance, a larger and larger amount of each monthly payment goes toward reducing the principal.

It is a wise idea for the borrower to stipulate that he can pay off the principal faster than the amortization schedule requires, if he desires to do so. Suppose you should unexpectedly inherit a few hundred dollars? You could use your windfall to reduce the mortgage and thus shorten the period before your home would be free and clear.

The direct reduction loan is cheaper for the borrower than the sinking fund loan. Its maturity and cost are absolutely fixed and the borrower knows every month just how he stands.

What about producer credit?

We have been talking so far about the kind of loans made for ordinary purposes of living—the kind technically called consumer credit. But out of the millions of men in the Army, a good many thousands are going to want to start out in business for themselves when they get out of the service. *Most of them will have to borrow money to do it.*

Money borrowed to start or run a business is called producer credit. The big difference between it and consumer credit is that the *borrower of producer credit hopes to make a profit out of it.*

The money that is invested in any business falls into two categories—"working capital" and "fixed capital." Working capital is the money that is tied up in such things as raw materials, goods being manufactured or awaiting sale, accounts receivable from customers, and so on. This money is only temporarily tied up, for it can be recovered comparatively quickly by the sale of the finished goods or the collection of the accounts receivable. These items are said to be "current" or "live" assets, and working capital is sometimes called "liquid" because it can be converted into cash in a short time.

Fixed capital consists of the money that is invested in the site, the buildings, the machinery, and other equipment of a business. It is called fixed because it could be converted back into cash only with considerable difficulty and possibly with a serious loss.

If the businessman or the industrialist has sufficient cash to pay for all his current needs of materials, labor, and other costs, he can do so and get a cash discount. But few businesses have enough cash to provide all the working capital they need. Most of them have current liabilities, consisting either of debts they owe the firms which supply them with goods and services, or debts they owe banks for money borrowed to pay for these goods or services.

These current liabilities normally run for a short term—usually 30, 60, 90, or 120 days. When a banker or a seller of goods extends short-term credit to a businessman or manufacturer, he takes into consideration only the debtor's ability to pay out of his current assets. He ignores the debtor's fixed assets, because the debtor can pay from this source only by selling the fixed assets—which means going out of business.

Because it is not always possible to liquidate current assets for the full value at which they are carried on the books of the borrowing concern, it is a rule in granting credit that the current assets must provide a liberal margin over the current liabilities. The ratio may stand at 3 to 2, or 2 to 1, depending upon the nature of the current assets—how stable their values are, and how easily marketable they are.

Current liabilities offer the businessman two great advantages. They enable him to get the materials and labor he needs for production in greater volume than he could if he had to depend entirely on his own working capital. They are also a source of profit, for if he can make the means of production pay a gross profit of 8 per cent, and the interest rate is only 6 per cent, he makes a net profit of 2 per cent.

Current liabilities consist of short-term accounts payable to the sellers of goods, and short-term notes or acceptances payable to a commercial bank. How does a businessman or an industrialist get credit from these sources? Obviously, only by convincing his creditors that he knows his business; that he is honest; that his record of debt paying is good; that his financial position is sound; and that his sales will yield enough to enable him to pay them.

Does it pay a businessman or an industrialist to incur short-term debt? That depends upon his ability to get credit upon reasonable terms and, even more, upon the soundness of his production and marketing plans. As all of us know, the risks that a businessman has to face are so many and so varied that meeting them puts a heavy strain on his foresight, ingenuity, and resourcefulness.

Experience shows, however, that most of our successful businessmen do not hesitate to incur short-term debts when they see a reasonable opportunity for profit.

Long-term borrowing for the purpose of obtaining fixed capital is accomplished either through mortgaging the plant or through the sale of bonds. It is hardly worth while to discuss this here, however, for very few, even of the vast numbers of men in the Army, are likely to attempt so ambitious a project immediately on leaving the service. Anyone who may do so is advised to consult the Smaller War Plants Corporation.

What does the government offer you?

Probably every man in the Army has heard about the GI Bill of Rights, as the Servicemen's Readjustment Act of 1944 is popularly known. This law has fifteen "chapters" grouped under six major "titles." Title III, the only one that directly concerns the topic of borrowing, provides for "Loans for the Purchase or Construction of Homes, Farms and Business Property."

Who is eligible?

Any veteran who served in the active military or naval service of the United States between September 16, 1940

and the end of the war, and was discharged or released under conditions other than dishonorable after having served ninety days or more, or by reason of an injury or disability incurred in the line of duty, will be eligible for federal guaranty of a loan to him.

How does he get it?

Any such veteran may apply within two years after his separation from the military or naval forces, or two years after termination of the war (whichever is the later date) but in no event more than five years after the war ends. He may ask the Administrator of Veterans Affairs for the guaranty of not more than half of a loan or a series of loans for various designated purposes. The total amount guaranteed must not exceed $2,000. If the administrator finds the veteran is eligible, and the loan appears practicable, he must make the guaranty.

What are the terms of the loan?

The law provides that loans guaranteed by the administrator are to be made payable under such terms and conditions as may be established by him. The law stipulates, however, that the interest rate shall not be more than 4 per cent a year and that the loan shall be payable in full within twenty years. No security for the guaranty of the loan will be required of the borrower. Interest for the first year on the guaranteed part of the loan will be paid by the administrator.

Such agencies of the federal government as the Farm Credit Administration and the Federal Housing Agency are authorized to loan money or to guarantee or insure loans to citizens for some of the same purposes as are covered in the GI Bill. Suppose a veteran gets a loan from

one of these agencies to cover part of the cost of building a house or buying a farm or whatever he wants to do. Under the GI Bill he may still be able to get a guaranty from the Veterans Administration of the entire amount of a second loan. However, the total amount guaranteed may not exceed \$2,000, and the second loan may not be for more than 20 per cent of the purchase price or cost of his home or farm.

In the case of a mortgage, the mortgagor and mortgagee must agree that, before beginning foreclosure proceedings for default of payments of principal or interest due, the administrator will be given at least thirty days' notice, with the option of bidding in the property on foreclosure or of refinancing the loan with another lending agency.

This probably means that every effort will be made to save for the veteran his equity in the property.

Where does the veteran get a loan?

Don't make the mistake of thinking that loans under the GI Bill are a new kind of government handout to veterans. They are not gifts of \$2,000 per veteran—or anything of the kind. They are business transactions in which a veteran borrows a sum of money—usually from a private lender—and obligates himself to pay it back with interest.

The Veterans Administration does not loan money, nor does it say how much a veteran can borrow or from whom. Like anyone else, veterans can borrow money as long as they can find somebody to lend it to them. What the government does under the GI Bill is simply to guarantee the lender against loss of 50 per cent, or up to \$2,000, of certain kinds of loans.

The lender may be a person, a firm, an association, a corporation, or a governmental agency or corporation, either

state or federal. The veteran, therefore, can go to anyone who wants to lend him money and together with the lender make application to the Administrator of Veterans Affairs for a loan guaranty. It's always a good idea, of course, to deal with a reputable person or firm. Incidentally, no brokerage or other charge can be made for "helping" a veteran get a loan guaranty.

What kinds of loans are guaranteed?

Title III provides for three general classes of loans:

1. For the purchase or construction of new homes, the payment of repairs on present homes, or the payment of delinquent debts, taxes, or assessments on them.
2. For the purchase or repair of farms and farm equipment.
3. For the purchase of business property, supplies, and equipment.

Home loans

A veteran's application for guaranty of a loan for the purchase or construction of a home which he intends to occupy may be approved if the administrator finds that:

1. The proceeds of the loan will really be used for the purpose stated.
2. The contemplated terms of payment of the mortgage bear a proper relation to the veteran's present and anticipated income and expenses, and the nature and condition of the property make it suitable for dwelling purposes.
3. The purchase price or construction cost of the property, including the unimproved lot, does not exceed the reasonable normal value, as determined by a proper appraisal.

An application for the guaranty of a loan to be used for the purpose of making repairs, alterations, or improvements in or paying delinquent indebtedness, taxes, or special assessments on residential property owned by a veteran and used by him as his home may be approved if the administrator finds that the proceeds of the loan will really be used for such purpose or purposes.

Farm loans

A veteran's application for the guaranty of a loan to be used in purchasing any land, buildings, livestock, equipment, machinery, or implements, or in repairing, altering, or improving any buildings or equipment to be used in farming operations conducted by the applicant, may be approved by the administrator if he finds that:

1. The proceeds of the loan really will be used for the purposes indicated.

2. The property will be useful in and reasonably necessary for efficiently conducting such operations.
3. The ability and experience of the veteran and the nature of the proposed farming operations are such as to show a reasonable likelihood that the operations will be successful.
4. The purchase price to be paid by the veteran does not exceed the reasonable normal value, as determined by a proper appraisal.

Veterans who want to be farmers and need money to do it should also follow up on the GI Bill provision which makes qualified veterans eligible for loans under the Bankhead-Jones Farm Tenant Act. Veterans with farm training or experience, even though they are not tenant farmers or sharecroppers, can get loans by this arrangement for buying farms and equipment, making repairs, paying debts, and supporting their families.

Business property loans

An application by a veteran for the guaranty of a loan to be used in purchasing any business, land, building, supplies, equipment, machinery, or tools to be used by the applicant in pursuing a gainful occupation (other than farming) may be approved by the administrator if he finds that:

1. The proceeds of the loan really will be used for the purpose indicated.
2. The property will be useful in and reasonably necessary for the efficient and successful pursuit of that occupation.
3. The ability and experience of the veteran and the conditions under which he proposes to pursue the occupation are such as to show a reasonable likelihood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that he will be successful in the pursuit of that occupation.

4. The purchase price to be paid for the property by the veteran does not exceed the reasonable normal value, as determined by a proper appraisal.

What are the rules and regulations?

When Congress passed the GI Bill it authorized the Administrator of Veterans Affairs to make whatever rules and regulations were necessary to carry out the loan provisions properly. These have now been issued in printed form. They tell how to apply for a loan guaranty, describe the bases on which applications will be judged, and go into detail as to what are the rights of veterans under the law.

Like most rules and regulations, these do not make easy reading. That's one reason for going to a reputable lender who knows what they are all about and will protect your interests as well as his own. But it is also a good idea to know the ropes yourself. The regulations can be had from the Veterans Administration in Washington or any of its local offices. They should also be available at any good bank or loan company. Federal agencies that make farm loans and home loans will have the regulations applying to those kinds of loans.

Look out for the con man

While you are reading the rules and regulations don't forget the guy who expects to play you for a sucker. He is laying plans right now to reap a golden harvest from veterans who can get money on easy terms—and lose it easier. Stop, look, and listen carefully before you sign away the benefits that a grateful nation has made available to you.

→ to the Leader ←

Many men have more or less well-defined postwar plans that will require a sizable outlay of money—money they expect to borrow in one way or another. Some plan to buy a farm; others to establish a business; others to build, remodel, or re-equip a house. The Army-wide publicity given to the loan features of the GI Bill of Rights has led some men to give thought to financing personal projects which they might otherwise never have considered. Other men have got the idea that, because the government will guarantee GI loans, the ex-soldier's obligation to pay up such loans will somehow be less than in the case of ordinary bank loans. Still others think that banks won't worry about returning servicemen as credit risks, but that all such a man will have to do is to walk into a bank and ask for a government-guaranteed loan. So, through encouraging the discussion of the material in this pamphlet, you will be providing men with an opportunity to set themselves straight on an exceedingly practical subject.

Possible approaches

How can you help a group of men to work out a live discussion on a seemingly personal question like "Does it pay to borrow?" The answer is to select one or more common situations in which borrowing money is a factor, and to help the members of your group talk them out. If you can find an ex-banker or ex-credit man in your unit, have him help you by sitting in to give expert technical information. It is also a good idea to make it possible for the men to read this pamphlet in advance. Put several copies in various key spots like the library, the service club, or day rooms. Finally, do not feel bound to use "Does it pay to borrow?" as your announced subject. Instead try to word your topic so that it will appeal to the specific interests of the men who attend your meetings. Here are two examples that may appeal to you: "Who should borrow money under the GI Bill of Rights?" or "Should a small business be started on borrowed money?" One of these topics or some other one that is tailored to the interests of your own group will bring a larger attendance to your meeting.

You, as the leader and organizer of an Army discussion group, are encouraged always to develop your meetings along lines that you know will enlist support from your particular group. All the suggestions given above, as well as the questions suggested below, should be accepted in this spirit. The same is true of the type of discussion meeting you hold—a forum, a panel discussion, or an informal discussion group.

Practical discussion materials

The techniques of various forms of discussion are outlined in EM 1, *GI Roundtable: Guide for Discussion Leaders,*

which also gives advice on the promotion of discussion programs. If you plan to broadcast roundtable discussions on stations or sound systems of the Armed Forces Radio Service, you will find practical suggestions on radio discussion methods in EM 90, *GI Radio Roundtable*. Other pamphlets already published in the *GI Roundtable* series are listed at the back of this manual.

1

Do you think that the loans provided by the GI Bill of Rights will help ease the transition from war to peace? Why do you think so? Under what circumstances should a man procure such a loan? How do the benefits of the GI Bill compare with these granted to the veterans of World War I? Of the Civil War?

2

Would you undertake to start your own business on borrowed money if you saw a favorable opportunity? How would you decide whether the risk was worth taking?

3

Do the advantages and convenience of installment buying outweigh its defects? Does the installment system encourage extravagant living?

4

Is a farmer justified in going into debt to buy a new suit of clothes? Is a garage mechanic? An insurance salesman?

Would each of these men be justified in borrowing the price of a suit of overalls?

5

Why do department stores solicit charge accounts and even favor such customers over those who pay cash? Should they quote two prices, one for cash and the other for credit?

6

Why can you usually get better terms for a loan if you make a large down payment than if you make a small one? Can you get a loan on better terms for the purchase of a new car than a used car? Why?

7

From your own experience and observation, how do you think debt affects the character of the debtor? Would you draw a distinction here between what the pamphlet defines as "consumer credit" and "producer credit"? Where does casual borrowing from acquaintances or friends come into this question?

Suggestions for Further Reading

These books are suggested for supplementary reading if it so happens that you have access to them. They are not approved nor officially supplied by the War Department. They have been selected because they give additional information and represent different points of view.

A number of committees and foundations have issued pamphlets which cover the fields of personal loans, borrowing, debt, credit, loan sharks, and so forth. Some of these make good supplementary reading to this pamphlet. The following are suggested:

LOAN SHARKS AND THEIR VICTIMS. By William T. Foster (1944).

CREDIT FOR CONSUMERS. By LeBaron R. Foster (1942).

CREDIT UNIONS—THE PEOPLE'S BANKS. By Maxwell S. Stewart (1942).

INSTALMENT SELLING—PROS AND CONS. By William T. Foster (1941).

The above four pamphlets are all published by Public Affairs Committee, 30 Rockefeller Plaza, New York, N. Y.

PAINLESS DEBTISTRY. By William T. Foster (1933). Reprinted from *North American Review*, June 1933.

PUBLIC SUPERVISION OF CONSUMER CREDIT. By William T. Foster (1939).

SMALL LOAN LAWS OF THE UNITED STATES (1943).

CONSUMER LOANS BY COMMERCIAL BANKS. By William T. Foster (1940).

The above four pamphlets are all published by Pollak Foundation for Economic Research, Newton, Mass.

FACTS VETERANS SHOULD KNOW BEFORE STARTING A BUSINESS (1944).

FACTS YOU SHOULD KNOW ABOUT BORROWING (1937).

The above two pamphlets, and others on related subjects, may be obtained either from the National Association of Better Business Bureaus, 212 Cuyahoga Building, Cleveland, Ohio, or from the nearest local Better Business Bureau.

THE PROS AND CONS OF CONSUMER CREDIT. By Constance Kent. Published by Workers Education Bureau Press, 1440 Broadway, New York, N. Y. (1941).

CONSUMER CREDIT. A series of articles in *Annals of the American Academy of Political and Social Science,* March 1938.

The following books may prove useful:

FINANCING THE CONSUMER. By Evans Clark. Published by Harper and Brothers, 49 East 33d St., New York 16, N. Y. (1930).

CONSUMER CREDIT AND ITS USES. By Charles O. Hardy. Published by Prentice-Hall, 70 Fifth Ave., New York 11, N. Y. (1938).

TERM LENDING TO BUSINESS. By Neil H. Jacoby and Raymond J. Saulnier. Published by National Bureau of Economic Research, 1819 Broadway, New York 23, N. Y. (1942).

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OTHER GI ROUNDTABLE SUBJECTS

Introductory copies of each new *GI Roundtable* pamphlet are automatically issued to information-education officers in the United States and war theaters. Additional copies are authorized on the basis of two to a company or similar organization. Pamphlets may be requisitioned from the United States Armed Forces Institute, Madison 3, Wisconsin, or from the nearest USAFI Oversea Branch. List EM number, *GI Roundtable* series, title, and quantity. New subjects will be announced as published. Subjects now available:

EM 1, Guide for Discussion Leaders
EM 2, What Is Propaganda?
EM 10, What Shall Be Done about Germany after the War?
EM 11, What Shall Be Done with the War Criminals?
EM 12, Can We Prevent Future Wars?
EM 20, What Has Alaska To Offer Postwar Pioneers?
EM 22, Will There Be Work for All?
EM 23, Why Co-ops? What Are They? How Do They Work?
EM 31, Do You Want Your Wife To Work after the War?
EM 32, Shall I Build a House after the War?
EM 33, What Will Your Town Be Like?
EM 40, Will the French Republic Live Again?
EM 41, Our British Ally
EM 42, Our Chinese Ally
EM 43, The Balkans—Many Peoples, Many Problems
EM 44, Australia: Our Neighbor "Down Under"
EM 45, What Future for the Islands of the Pacific?
EM 46, Our Russian Ally
EM 90, GI Radio Roundtable

DOES IT PAY TO BORROW ?